

STATE OF NEW YORK
DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
	:	
of	:	
CONTINUITY GRAPHIC ASSOCIATES, INC.	:	SMALL CLAIMS DETERMINATION DTA # 819852
for Revision of a Determination or for Refund of	:	
Sales and Use Taxes under Articles 28 and 29 of the	:	
Tax Law for the Period June 1, 2002 through August	:	
31, 2002.	:	
_____	:	

Petitioner, Continuity Graphics Associates, Inc., 15 West 39th Street, New York, New York 10018, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 2002 through August 31, 2002.

A small claims hearing was held before Thomas C. Sacca, Presiding Officer, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on January 19, 2005 at 1:15 P.M. Petitioner appeared by Terry I. Weberman, CPA. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Michael J. Miller and Terry A. Marra).

Since neither party elected to reserve time to file a brief, the three-month period for the issuance of this determination began as of the date the hearing was held.

ISSUE

Whether petitioner's purchases of electricity were exempt from the imposition of sales tax because the electricity was used directly and exclusively in the production of tangible personal property for sale.

FINDINGS OF FACT

1. Petitioner is in the business of manufacturing original art work and videos for the advertising industry.

2. On June 18, 2002, petitioner filed with the Division of Taxation an application for credit of sales and use tax for the period June 14, 1999 through June 14, 2002. The amount claimed of \$4,214.79 was the total of the New York State and City sales tax paid by petitioner to Con Edison for electric usage for the period of the credit application. The claimed amount included New York City sales tax paid prior to November 1, 2000 of \$1,013.02. The credit claimed was reported on petitioner's sales and use tax returns for the quarters ended May 31, 2002 and August 31, 2002.

3. On October 7, 2002 and November 7, 2002, the Division wrote to petitioner explaining that additional information would be needed to complete the review of the application for credit of sales tax. The letter stated that, although petitioner was claiming a 100% exemption on its purchases of electricity, electricity purchased for such general uses as heating, lighting or air conditioning of the office and manufacturing areas is taxable. Therefore, it would be necessary for petitioner to compute an allocation percentage to determine the amount of electricity used in a taxable and nontaxable manner. Petitioner did not respond to either of the Division's requests.

4. On December 20, 2002, the Division notified petitioner that its claim for credit of sales tax was being denied in full. The Division adjusted petitioner's sales and use tax return for the quarter ended May 31, 2002 to reflect the denial of the credit claim, and also adjusted the return for the quarter ended August 31, 2002 to remove the credit carried over from the denied period. The denial letter explained that all receipts from the sale of property or services of any type mentioned in section 1105 of the Tax Law were subject to tax until the contrary was established,

and that petitioner had not met its burden to establish that the receipts for the electricity were not taxable. Petitioner did not protest this denial letter.

5. Subsequent to the issuance of the denial letter, the Division issued to petitioner Notice of Determination L-021793520 for the period June 1, 2002 through August 31, 2002 assessing sales tax due in the amount of \$2,072.52, plus penalty and interest. The purpose of the notice was to eliminate and assess the amount of the claimed credit taken by petitioner on its sales tax return for the quarter ended August 31, 2002.

SUMMARY OF THE PARTIES' POSITIONS

6. In a letter dated August 27, 2003, petitioner enclosed its own analysis of the lighting, personnel and equipment it employed and their respective uses in both the administrative and manufacturing processes of the business. Petitioner concluded that its lighting usage was employed 80% in manufacturing, its personnel 83% in manufacturing and its equipment at least 95% in manufacturing. Petitioner claimed that based upon the high percentages computed, it would be reasonable to conclude that 90% of its electric usage was employed in the manufacturing process.

In support of the percentages determined, petitioner stated at the hearing that the lighting used by the business operation was a necessary and essential part of every aspect of producing the advertising products. The manufacturing process that the business was involved in could not occur without lighting. In addition, petitioner argued that, with few small exceptions, all employees were involved in production for almost all their time spent at the office, and that most of the equipment was used in the manufacturing of advertising products.

7. The Division initially points out that the claim for credit included New York City sales tax which was not exempt from tax until November 1, 2000. Therefore, according to the

Division, petitioner, by claiming 100% of the sales tax paid to Con Edison, claimed \$1,013.02 of New York City sales tax paid prior to November 1, 2000 which was not refundable, even were it to be determined that it was entitled to the exemption. The Division also notes that in order to determine the proper allocation of the electricity used between administrative and manufacturing functions, it was necessary for petitioner to produce either an electrical engineer's survey or apply the appropriate computations to its electrical usage. As petitioner failed to do either, it has not established what percentage of its electrical purchases was used in the manufacturing process.

CONCLUSIONS OF LAW

A. Tax Law § 1115(c) provides that fuel, gas, electricity, refrigeration and steam and like services are exempt from the New York State sales and use taxes when used directly and exclusively in the production for sale of tangible personal property. This same exemption is applied to the New York City sales and use taxes for purchases after November 1, 2000 (*see*, Tax Law § 1107[b]).

B. The Division correctly points out that a portion of petitioner's credit claim includes New York City sales tax paid for the purchase of electricity prior to November 1, 2000. Therefore, petitioner's claim for credit of sales tax paid is reduced by \$1,013.02 of New York City sales tax paid which is not eligible for the exemption.

C. The New York State sales and use tax regulations (20 NYCRR 528.22) provide, in relevant part, as follows:

(a) . . . (2) . . . [E]lectricity . . . used or consumed in the heating, cooling or lighting of buildings . . . , is subject to the sales tax.

* * *

(c) *Directly and exclusively.* (1) *Directly* means the . . . electricity . . . must during the production phase of a process, either:

- (i) operate exempt production machinery or equipment; or
- (ii) create conditions necessary for production; or
- (iii) perform an actual part of the production process.

(2) Usage in activities collateral to the actual production process is not deemed to be used directly in production.

* * *

(3)(i) *Exclusively* means that the . . . electricity . . . is used in total (100%) in the production process.

(ii) Because . . . electricity . . . when purchased by the user is normally received in bulk or in a continuous flow and a portion thereof is used for purposes which would make the exemption inapplicable to such purchases, the user may claim a refund or credit for the tax paid only on that portion used or consumed directly and exclusively in production.

* * *

(iv) The user must maintain adequate records with respect to the allocation of . . . electricity . . . used directly and exclusively in production and for nonexempt purposes.

(v) For the purpose of substantiating the allocation of . . . electricity . . . used directly and exclusively in production from that used for nonexempt purposes, the user must, when claiming a refund or credit, submit an engineering survey or the formulae used in arriving at the amounts used in an exempt manner.

D. In order to be eligible for the exemption for the purchase of electricity, a taxpayer must provide either an electrical engineer's survey or the formulae used to determine what portion of the electricity was used directly and exclusively in the production process (*see*, 20 NYCRR 528.22; TSB-M-82[25]S). Petitioner has failed to provide adequate records relative to the allocation of electricity purchased from Con Edison which would establish the proper allocation of the use of the electricity between the administrative and manufacturing functions. As such, the Division properly determined that such purchases were subject to the imposition of sales tax.

E. As the Division correctly argued at the hearing, none of the electricity which was purchased to light petitioner's business operation is exempt from the imposition of sales tax as it is considered collateral to the production process (*see*, 20 NYCRR 528.22[c][2]). The Division further points out that petitioner's conclusion as to the percentage of its employees who were involved in the production process did not contain an analysis of the equipment used by such employees, the purpose of such equipment, the equipment's hours of operation and the amount of electricity used by each piece of equipment. The information used by petitioner to determine the percentage that its equipment was used in the production process was also flawed. There was no identity of the amount of electricity used or the hours of operation of the equipment, and the percentage of use was based solely upon the number of pieces of equipment. Such an analysis does not recognize that different pieces of equipment use different amounts of electricity, and, for example, equated an air conditioner with 24,000 BTU capacity with a computer monitor. In addition, the conclusions reached by petitioner were suspect as the seasonal fluctuations in the Con Edison bills were not reflected in the results, such fluctuations being consistent with the use of electricity in the cooling of the office space during the warmer months. In conclusion, it is determined that petitioner has failed to establish the proper allocation percentage of its electricity purchases which were used directly and exclusively in the production process.

F. The petition of Continuity Graphics Associates, Inc. is denied, and the Notice of Determination (L-021793520) is sustained.

DATED: Troy, New York
April 7, 2005

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE